

CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

Minutes

April 19, 2005

The Capital Projects and Bond Oversight Committee met on Tuesday, April 19, 2005, at 1:00 PM, in Room 129 of the Capitol Annex. Representative Mike Denham, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative Mike Denham, Co-Chair; Senator Elizabeth Tori, Co-Chair; Representatives Paul Marcotte and Jim Wayne; and Senators Tom Buford, Jerry Rhoads, and Dan Seum.

Guests testifying before the Committee: Tom Denton and Dewey Yeatts, Murray State University; Bob Wiseman, University of Kentucky; Bill Hintze, Governor's Office for Policy and Management; Jim Abbott, Finance and Administration Cabinet; Keith Rogers, Governor's Office of Agricultural Policy; and Tom Howard, Office of Financial Management.

LRC Staff: Nancy Osborne, Pat Ingram, Kevin Mason, Bart Hardin, and Shawn Bowen.

Representative Denham introduced Senator Elizabeth Tori as a new member of the Committee, and welcomed her to the meeting.

Representative Denham recognized the services of Senator Bob Leeper who was not reappointed to the Committee. Senator Leeper was a member of the Committee for thirteen years, and served as vice chair or co-chair for nine years. Representative Denham said Senator Leeper worked hard and did an excellent job. Senator Tori added that Senator Leeper served with diligence, drove many miles to Frankfort, and was well prepared for meetings. She made a motion that the staff draft a resolution from the Committee honoring Senator Leeper for the many years he served on this Committee. The motion was seconded by Representative Marcotte and passed by unanimous voice vote.

Representative Marcotte made a motion to approve the minutes of the March 22, 2005, meeting as submitted. The motion was seconded by Senator Buford and passed by unanimous voice vote.

Representative Denham said the Committee would hold elections today for new Senate and House Co-Chairs since the Senate and House Leadership has made new appointments and reappointments to statutory committees. He asked Ms. Nancy Osborne, Committee staff, to chair the election process.

Ms. Osborne opened the floor for nominations for Committee Co-Chair (Senate). Senator Buford nominated Senator Elizabeth Tori to serve as Committee Co-Chair. The nomination was seconded by Senator Seum.

Senator Seum made a motion that the nominations be closed and that Senator Tori be elected as Committee Co-Chair by acclamation. The motion was seconded by Senator Buford, and Senator Tori was elected by acclamation.

Ms. Osborne opened the floor for nominations for Committee Co-Chair (House). Representative Wayne nominated Representative Mike Denham to serve as Committee Co-Chair. The nomination was seconded by Representative Marcotte.

Representative Wayne made a motion that the nominations be closed and that Representative Denham be elected as Committee Co-Chair by acclamation. The motion was seconded by Representative Marcotte, and Representative Denham was elected by acclamation.

Ms. Osborne briefly reviewed six items of correspondence included in members' folders: a memorandum reporting the use of approximately \$482,000 in insurance proceeds and about \$41,000 from the state's Emergency Fund to reconstruct buildings burned in the 2002 Fort Boonesborough State Park fire; quarterly reports from the Finance and Administration Cabinet, Murray State University, University of Kentucky, University of Louisville, and Western Kentucky University; a quarterly report from the Administrative Office of the Courts; the Semi-annual report of the Kentucky Asset/Liability Commission; a notice of plans by the University of Louisville to use the Design-Build construction delivery method for the Indoor Practice Field; and the Kentucky Lottery Corporation's monthly financial report for February 2005.

Senator Seum asked if the buildings at Fort Boonesborough were underinsured. Mr. Hintze from the Governor's Office of Policy and Management said he would find out and provide a written response to the Committee.

Ms. Osborne said Committee folders also included three information items: a staff update on various capital projects; a list of capital projects included in the enacted state/executive branch budget; and legislation proposed in the 2005 Regular Session relating to the jurisdiction of the Capital Projects and Bond Oversight Committee.

Representative Denham called on Tom Denton, Vice-President for Finance and Administrative Services, Murray State University (MuSU) and Dewey Yeatts, Chief Facilities Officer and Associate Vice President, MuSU, to discuss an Energy Savings Performance Contract (ESPC).

Mr. Yeatts said MuSU began to consider energy savings improvements on the campus approximately five or six years ago. Last spring MuSU submitted a Request for Proposals (RFP) to the energy service companies. The university received six responses from qualified firms. Three firms were short-listed, and a selection committee unanimously chose Chevron Energy Solutions.

Mr. Yeatts said Chevron performed a comprehensive energy audit and looked at 62 buildings throughout the campus. Chevron then developed and recommended a list of energy conservation measures to MuSU. He said they worked closely with the Finance and Administration Cabinet and the Office of Financial Management to make sure MuSU met their criteria.

Mr. Yeatts said MuSU entered into a contract with Chevron in February 2005, the project is underway, and the work is on schedule as planned. He said Chevron has a full-time construction manager that has set up an office on campus and is there everyday monitoring the work. Mr. Yeatts said 80% of the work is lighting retrofits, 10% is mechanical system retrofits, and the remaining 10% relates to plumbing and water conservation.

Mr. Yeatts said there are a number of ways to measure and verify the results of this project. He said they chose to use the international performance measurement and verification protocol. This method allows the contractor, with MuSU's presence, to measure the energy consumption pre-improvement and post-improvement to make sure the savings are what Chevron stipulated them to be.

Senator Buford questioned the value of the project if guaranteed savings are \$8,690,844 and it costs \$8,613,840. Mr. Yeatts said that the financing mechanism is a lease-purchase agreement with CitiCapital for a principal amount of \$6.7 million financed over a 12-year term and includes interest of \$1.9 million. When MuSU issued the RFP for the financing package, there were eight different bidders that resulted in the university getting a very competitive interest rate of 3.94%. Using an ESPC also allows the university to accomplish improvement to facilities that enhance the comfort and well-being of the students and faculties, improve the learning environment, and reduce maintenance costs. These are all major goals in addition to saving energy and reducing energy costs.

Senator Seum asked why there were no improvements to the heating and cooling systems which would yield more energy savings. Mr. Yeatts said that such improvements

would not meet the cash-flow requirements since there is a limit of a 12-year financing term in the ESPC guidelines developed by the Finance and Administration Cabinet. Since lighting improvements have a much quicker payback, that is the majority of MuSU's project.

Senator Buford noted that energy conservation measures are to be installed in the Blackburn Science Center, but that facility is ultimately planned for demolition by MuSU after it has completed the New Science Complex. Since the improvements are financed over 12 years, and Blackburn may be demolished prior to that time, Senator Buford asked how the Blackburn energy conservation measures improve cash flow. Mr. Denton said that the Blackburn Science Center would still be used for 4-5 years and that MuSU was reconsidering including Blackburn in the project since it may be taken out of service.

Senator Buford noted that the state has issued ten ESPCs totaling about \$38 million since June 2004 and wondered if there had been any discussions about how the process was working and particularly if there was a better way to finance the projects.

By way of background, staff mentioned that six of the ten ESPC's were reported in February 2005 and at that meeting, the Executive Branch briefly discussed its new policy guideline manual entitled "*Energy Savings Performance Contracts Energy Management*." [Prior to development of the manual, members of the Committee had indicated interest in better state guidance on the use of energy savings performance contracts.]

Representative Denham asked if there was any further discussion. Seeing none, he said no further Committee action was required on the Murray State University ESPC, and thanked the university representatives for their attendance and report.

Next, Mr. Bob Wiseman, Vice President for Facilities, University of Kentucky (UK), reported two projects for the University. He first reported a modification relating to paying the prevailing wage for construction of the Hope Lodge by the American Cancer Society. [In September 2002, UK reported to the Committee that it planned to enter into a land lease with the American Cancer Society to enable the Society to build a facility on the University campus to house cancer patients undergoing outpatient treatment. The project will consist of an office wing, lodge rooms, and parking.]

Mr. Wiseman said the Cancer Society requested and received an opinion from the Legal Division of the Environmental and Public Protection Cabinet as to whether or not the state's prevailing wage law applied to construction of the Hope Lodge. The Labor Legal Division's opinion said since the Lodge will not be used for a public purpose, and the state will not control the Lodge after construction, and no state funding will be used in the construction or operation of the Lodge, the construction of the Lodge is not a public works. The opinion concluded, therefore, the Cancer Society is not subject to

Kentucky's prevailing wage requirements. Mr. Wiseman said that in light of this opinion, it is UK's intention to allow the American Cancer Society to proceed without the prevailing wage requirement. He said he understood the University's obligation to update and inform the Committee about this project.

Mr. Wiseman said he had spoken with Representative Denham, Representative Wayne, Committee staff, and Larry Roberts, Executive Director of the Kentucky State Building Trades, prior to today's meeting.

Representative Wayne said he recognized the American Cancer Society was trying to be good stewards of its money, but he was disappointed with their decision to seek a legal opinion about paying the prevailing wage. He said in the past he had worked with the American Cancer Society, and that he did not agree with the decision to not pay prevailing wage for this construction project because it does not serve the larger goal of justice for all. Representative Denham said this project did not require any action.

Mr. Wiseman next reported a lease renewal for the UK Department of Psychiatry. He said the Department of Psychiatry plans to renew its lease with Blazer Parkway Ventures for five years at an annual cost of \$412,653. The facility houses offices and is a clinic for out-patient treatment.

Representative Wayne asked where this space is located and whether the University plans to return its out-patient clinic to the Medical Center campus. Mr. Wiseman said the leased space is in the Richmond Road and Man-O-War area. UK has decided to maintain a leased space due to the continuing shortage of space on campus which should be relieved with the construction of the UK Bed Tower. It is UK's goal to move the out-patient function back to campus when space becomes available.

Representative Wayne asked how UK plans to coordinate off-campus psychiatric facilities and UK's on-campus facilities. Mr. Wiseman said he did not know, but he would find out and let the Committee know.

Senator Tori noted the proposed leased cost per square foot was higher than the average generally paid by the University in the Lexington market. Mr. Wiseman responded that the space is considered Class A and the lease is for a 5-year term.

Senator Buford made a motion to approve the UK Department of Psychiatry lease. The motion was seconded by Senator Rhoads and passed by unanimous roll call vote.

Representative Denham asked Mr. Bill Hintze, Deputy Budget Director, Governor's Office for Policy and Management, and Mr. Jim Abbott, Commissioner of Facilities and Support Services, to present the Finance Cabinet's monthly report to the Committee. Mr. Hintze reported an unbudgeted project for the Department of Military

Affairs to renovate the basement area of Building #1 at Bluegrass Station. He said the project is being initiated because the basement has mold problems and a recent mold abatement study indicates that the basement's drywall and finishes need to be removed and cleaned. He said temporary space is also needed for the Special Operation Forces Support Activity (SOFSA) personnel until the Hangar/Warehouse/Office Building authorized by the 2005 General Assembly is completed. Mr. Hintze said the project scope is \$1,300,000 (\$800,000 federal funds and \$500,000 restricted funds from Bluegrass Station's Maintenance Pool).

Representative Wayne asked what the facility's use will be. Mr. Hintze replied that the renovated space would serve as office space for the contractor and that the helicopters repaired at the facility would be used by Special Forces in foreign conflicts in Iraq and Afghanistan. Mr. Hintze added that the bond issue to finance the Hangar/Warehouse/Office Building is on the Committee's agenda for today.

Senator Buford made a motion to approve the Bluegrass Station Renovation project. The motion was seconded by Senator Tori, and passed by roll call vote. Six members voted affirmatively; Representative Wayne voted no.

The next project reported by the Finance and Administration Cabinet was the sublease of the marina at Lake Barkley. Mr. Abbott said the state leases the property encompassing Lake Barkley from the federal government. In October 2004, the Department of Parks issued an RFP to advertise a new sublease for the operation and maintenance of the marina to a private entity; the term of the sublease for the then-current private operator was due to end in December 2004. A condition of the new sublease is that capital improvements to replace two deteriorated piers, a storage building, and the fuel dock are to be made within 18 months of the lease award. The sublease is for a 15-year term with a 10-year option to be negotiated at the end of the initial term. Six proposals, including two from Edward Higgins, the prior private operator, were received and B-Mar & Associates was awarded the sublease. Mr. Abbott noted that the successful bid was about double what the other bidders offered.

In response to a question from Representative Wayne, Mr. Abbott said that a private entity has operated the marina since 1965, but this sublease is different from previous subleases at Lake Barkley because the private operator will own all of the improvements, equipment, and inventory, and will be responsible for all maintenance of the facility. The state is moving away from operating or maintaining marina facilities located at state parks.

In response to a question from Senator Rhoads, Mr. Abbott said B-Mar & Associates were checked out thoroughly and they are an experienced company.

Representative Denham said while the marina project would serve a state agency, the overall character of the project appears to be one that should be considered reportable and no further action is required.

Representative Denham said also included in members' folders were three reports from the Kentucky Infrastructure Authority: a Fund B grant for the City of Paris and two Tobacco grants for Mt. Olivet and Hardin County. He said no further action was required on these projects since they were previously approved.

The next report was provided by Mr. Tom Howard, Deputy Executive Director, Office of Financial Management (OFM). Mr. Howard presented four new bond issues. The first new bond issue was the Kentucky Housing Corporation (KHC) Single Family Housing Revenue Bonds, 2005 Series C, D & E, or additional series as may be designated in an amount not to exceed \$90 million. The proceeds from this issue will be used to provide mortgage financing for first-time low and moderate income Kentucky homebuyers.

Representative Wayne made a motion to approve the KHC bond issue. The motion was seconded by Senator Seum and passed by unanimous roll call vote.

The second new bond issue Mr. Howard presented was Kentucky Asset/Liability Commission (ALCo) Project Notes, 2005 General Fund First Series (Phase II Tobacco Settlement payments). The proceeds from this issue will provide financing for the General Fund (tobacco) supported Phase II Tobacco Settlement state payments to the beneficiaries (tobacco growers) of the National Tobacco Growers Settlement Trust as authorized by the 2005 General Assembly.

Representative Denham stated that the debt service appropriation in the budget bill for the Phase II payments assumed a taxable issue. The OFM analysis presents this as a tax-exempt issue. He asked what was the basis for making it tax exempt. Mr. Howard explained that there are two types of governmental bonds - public bonds that have a public purpose and are tax-exempt, and private activity bonds that may avoid a taxable status if certain criteria are met. (Private activity bonds may be subject to the Alternative Minimum Tax.)

Representative Denham asked about the timeline for making the state payments. Keith Rogers, Executive Director of the Governor's Office of Agricultural Policy, stated that from the time bond proceeds are actually available, it will take about three weeks to process the checks. The Wachovia Bank is under contract to process checks for the trustee in the National Tobacco Growers Settlement Trust case and the Commonwealth would contract with Wachovia to process the state payments as well. Mr. Rogers noted there were about 163,000 beneficiaries.

Senator Buford said these state payments are being made in lieu of the National Tobacco Growers Settlement Trust case. He asked what would happen if an appellate ruling in the Trust case favored the beneficiaries and the Phase II payments were received by the beneficiaries from the Trust as well as from the bond proceeds. Mr. Rogers said the beneficiaries must assign to the state their rights to money under the Trust Fund as a condition of receiving state payments.

Senator Buford made a motion to approve ALCo Project Notes, 2005 General Fund First Series, contingent upon approval of assignment of moneys from the Tobacco Growers Settlement Trust Fund.

There was a discussion of the on-going litigation in the National Tobacco Growers Settlement Trust case in North Carolina that is on appeal from a lower court ruling in favor of the tobacco manufacturers. Mr. Rogers said that a May 16th hearing had been scheduled before the North Carolina Supreme Court and a ruling is anticipated as soon as mid-July.

Mr. Hintze said if the state can recover from the court what they think they should have had, either the state can pay off the bonds that were just issued, or the money recovered can be used to offset the equivalent cost of other already authorized bond projects supported by the General Fund. This includes projects authorized from General Fund supported bonds in this 2005 session. He said they would weigh which of the two alternatives would be better for the state and its fiscal position.

In response to a question by Senator Tori concerning the need for further legislative action, Representative Denham said that he assisted in the drafting of HB 132 that was folded into the budget bill. He said he thought the intent of the 2005 legislation was clear - if funds become available because of a court settlement after the bond proceeds are used to pay the beneficiaries, the funds from the court settlement would then be used for Phase I tobacco settlement via the Governor's Office for Agricultural Policy after the funds are repaid. He said he did not believe further legislative action is required according to the language in the bill.

Mr. Hintze said there is a subsection of the budget bill describing what should happen. First of all, the cost of the bond issue should be addressed, and then any further recoveries would go to the Governor's Office of Agricultural Policy. He said they will have to weigh what the tax code and the IRS code permits the state to do. Mr. Howard added that there are several issues to be resolved, including determination of whether the beneficiaries can assign their rights to settlement money to the state and determination of the tax status of the bonds.

Senator Buford asked whether there was a deadline in the budget bill when the state was to mail the checks to the beneficiaries. Mr. Hintze replied there was no deadline in the legislation.

Mr. Hintze said the legislative intent is clear that the state is to expedite payments to the farmers. But the state is in a difficult position in that the state must also do what is prudent to protect the taxpayers, comply with the IRS code, and not jeopardize any other bonds the state will sell in the future. The executive branch agencies have numerous attorneys working with them to assure compliance. He added that the assignment of rights and the nature of the funds that would come back to the state in the event of an assignment are complex matters.

Senator Buford withdrew his motion. He then made a motion to approve ALCo Project Notes, 2005 General Fund First Series, as originally presented. The motion was seconded by Representative Wayne and passed by unanimous roll call vote.

Senator Tori asked for a brief update of the executive branch representatives' meeting in New York with bond rating agencies. Mr. Howard said that he, Mr. Hintze, Secretary Rudolph, and the Governor met with the rating agencies and discussed the state budget and the tax measures passed in March by the General Assembly. They also discussed the economic forecast for the Commonwealth, recent revenue trends, employment trends, the recently enacted budget, and the Rainy Day Fund. Mr. Howard noted that the success of the meeting was mirrored in the ratings assigned to the Commonwealth's recent April sale of bonds by the Turnpike Authority which retained the same ratings assigned to previously issued bonds - Moody's-Aa3, Standard & Poor's-A+, and Fitch-AA-.

The next new bond issue Mr. Howard discussed was ALCo Project Notes, 2005 Agency Fund First Series. The proceeds from this issue, \$14,885,000, will provide financing for the Military Affairs-Bluegrass Station - Hangar/Warehouse/Office Building project.

Representative Denham asked why this issue is considered taxable. Mr. Howard said that since more than 5% of the lease is being paid with federal funds, the issue must be taxable.

Senator Buford made a motion to approve ALCo Project Notes, 2005 Agency Fund First Series. The motion was seconded by Representative Marcotte and approved by voice vote. Five members voted affirmatively; Representative Wayne voted no.

The next new bond issue presented was Kentucky Asset/Liability Commission Project Notes, 2005 Federal Fund 1st Series Grant Anticipation Revenue Vehicle (GARVEE) bonds. The proceeds from this issue, \$151,404,534, will provide financing

for the Federal Fund supported GARVEE bonds. The required debt service will be paid from the Commonwealth's federal highway dollars. This is the first time the state has issued federal fund supported road bonds. [These bonds are tax-exempt, even though they are federal fund supported because there is a special tax exemption for GARVEE bonds.]

Representative Marcotte made a motion to approve ALCo Project Notes, 2005 Federal Fund 1st Series. The motion was seconded by Senator Tori and approved by unanimous roll call vote.

Mr. Howard presented another new bond issue: ALCo General Fund Tax and Revenue Anticipation Notes 2005, in an amount not to exceed \$800 million. The proceeds from this issue will be used to provide seasonal working capital for the General Fund during fiscal year 2006. Mr. Howard said even though they are authorized to issue up to \$800 million, they anticipate issuing approximately \$600 million. He said they expect a net benefit of \$5 million to the General Assembly, as a result of this transaction. Mr. Howard said this issue did not require formal Committee approval, but it is being presented to the Committee for informational purposes.

Mr. Howard then presented a new bond issue for the Turnpike Authority of Kentucky, Economic Development Road Refunding Bonds, 2005 Series A and Economic Development Road Revenue Bonds, 2005 Series B. The Series A bonds (\$33,629,263) will be used to refund outstanding bonds and the Series B bonds (\$227,267,634) will be used to fund half of the road fund authorization for the state construction program. He noted the better than anticipated ratings for this bond issue that were discussed with the Committee earlier in the meeting. Representative Denham said this bond issue did not require Committee approval.

In response to a question from Senator Tori, Mr. Howard said the true interest rate for the new money portion of the Turnpike Authority bond issue was 4.294% and the overall combined interest rate for both the refunding and the new money portion was 4.253%.

Mr. Howard next presented one follow-up report for a previously approved bond issue: Kentucky State Property and Buildings Commission (SPBC) Revenue Refunding Bonds, Project 84, \$182,845,000. Representative Denham said this was a previously approved issue, and no further action was required for this report.

Mr. Howard presented fourteen new school bond issues with School Facilities Construction Commission (SFCC) debt service participation: Adair County, Bath County, Boyle County, Carroll County, Carter County, Hopkins County, Jefferson County, Knox County, Letcher County, Marion County, Morgan County, Raceland-Worthington Ind. (Greenup Co.), Russell County, and Todd County.

Representative Marcotte made a motion to approve the fourteen school bond issues. The motion was seconded by Senator Buford and passed by unanimous roll call vote.

Representative Denham said there were two locally-funded school bond issues submitted to the Committee for review this month: Beechwood Ind. (Kenton Co.) and Clinton County. He said all disclosure information has been filed, and no further action on the bond issues was required.

Also included in members' folders was the debt issuance calendar. No action was required for this report.

Representative Denham said the Committee's next meeting is scheduled for May 17 at 1:00 p.m. in Room 129, Capitol Annex.

With there being no further business, Senator Buford made a motion to adjourn the meeting. The motion was seconded, and the meeting adjourned at 2:35 p.m.